The challenges, disclosure and statutory aspects of Board remuneration

Philippe Weber, member of the Board and the Compensation Committee at EDAG Engineering Group, Leonteq, Medacta and PolyPeptide

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swissVR Monitor: What are the dos and don'ts of Board compensation?

Philippe Weber: I think three aspects are crucial: appropriateness, independence and transparency. Remuneration should enable Board members to spend the time and take the care they need to fulfil their role of overseeing management, both in good and in bad times. In any assessment of appropriateness, benchmarks – comparisons with other companies, ideally of a comparable size and operating in the same sector – can help. However, such peer reviews must always reflect the fact that time spent on Board activities and the risk Board members face vary significantly from case to case and, specifically, reflect the size, complexity, financial strength and level of maturity and/or dynamic of the company, the regulatory environment, the ownership structure, the size of the Board and specialist expertise of its members, the number of committees and how often they meet, and the Board's relationship with the company's management team. Time spent on Board activities and the statutory and reputational risk to the Board are also likely to be higher in a listed company than a privately owned company. To sum up, the appropriateness of remuneration has to be assessed in the round; it is unhelpful simply to compare one company with others.

Philippe Weber studied law at the University of Zurich, where he also gained his PhD (summa cum laude) in 1995. After obtaining an LL.M. (with distinction) at the European University Institute in Fiesole, he joined Niederer Kraft Frey (NKF) and became a partner in 2002. Between 2015 and 2021, he was Managing Partner at NKF. As joint Head of NKF Transaction Teams, Philippe Weber regularly represents Swiss and international clients, including large corporates, investment banks, private equity, sovereign wealth funds and other investors, in complex major corporate/M&A and capital market transactions. He was, for example, the lead Swiss lawyer in the IPOs of Stadler Rail, SFS, VAT, Landis+Gyr, Medacta, PolyPeptide, EFG International and EPIC Suisse AG. Chambers Global and other rankings have for many years awarded Philippe Weber top tier ranking for M&A and capital markets. He has recently been named Swiss M&A Lawyer and Swiss Capital Markets Lawyer of the Year 2022 by Legalcommunity.

The criterion of independence is increasingly important for the Boards of listed companies. That's why I think it is important for non-executive Board members to maintain financial independence – that is, they should not be so dependent on their Board remuneration that they are in some way constrained in the way they operate. Companies also often want the Board to 'have skin in the game', so it may be sensible to allocate shares – perhaps with minimum holding periods – as part of a flat-rate payment. The Swiss Code of Best Practice for Corporate Governance, however, recommends that options and similar arrangements should not form part of Board remuneration. It also recommends that non-executive directors should not be paid a profit-related bonus and that such bonuses do not form part of long-term incentive plans.

The Swiss Corporate Law now integrates provisions from the Final Ordinance against Excessive Remuneration as a result of what is known as the 'Minder initiative', so listed companies are generally very transparent, and this transparency is a statutory requirement and enforced by law. In the case of non-listed companies, however, the Swiss Corporate Law makes very little provision for transparency, in particular under Article 697 ff. of the amended Swiss Code of Obligations. In individual cases, it is therefore advisable to include further-reaching provisions in the company statutes, for example in relation to having the Annual General Meeting determine or approve Board remuneration rather than the Board of Directors itself (as is actually laid down by law). In the case of larger non-listed companies, we could also envisage voluntary application of (parts of) the Swiss Code of Best Practice for Corporate Governance or of statutory rules for remuneration in listed companies. However, this would need to be considered very carefully and on a case-by-case basis.

swissVR Monitor: **What are the biggest challenges in Board remuneration (appropriate rates/amounts, fair distribution, differences between Board members, etc.)?**

Philippe Weber: I would echo a lot of my previous answer. In my experience, the differences between Board members' remuneration are based on objective criteria and seldom give rise to debate. For example, it is common for all Board members to receive a flat-rate basic payment plus further payments for those with additional roles, such as member of the Executive Committee, Lead Independent Director, President or committee member. In some cases, companies also pay a fee per meeting attended. As mentioned earlier, I think variable remuneration for non-executive Board members is very much the exception.

Over recent years, Board members in many companies have faced unusually high workloads and spent much more time on their mandate as a result of the pandemic, the war in Ukraine, supply chain difficulties, interest rate changes and rising inflation, among other factors. You often hear the argument that when a company is going through tough times, Board remuneration should be reduced. Of course, this may be appropriate, but companies also need to bear in mind that most Board members receive a flat-rate payment. If Board members do not receive a variable bonus in good times, then it is only fair that in bad times, they receive an appropriate payment for their workload and the higher statutory and reputational risk they often face.

swissVR Monitor: **In your opinion, how important is the disclosure of Board remuneration to stakeholders such as shareholders?**

Philippe Weber: Shareholders are the owners of the company and deserve transparency in relation to Board remuneration. Against that backdrop, I welcome Switzerland's progressive rules for listed companies, which were introduced following the 'Minder initiative' and now form part of the amended Swiss Corporate Law. I think the requirement for transparency has improved the quality of the work done by Remuneration Committees in listed companies, for example by enhancing the importance of remuneration issues. Shareholders in non-listed companies have only limited statutory rights to information, and getting those rights upheld in the courts is an onerous process. In individual cases, such as large companies preparing to float on the stock market, it is advisable for Boards voluntarily to agree further-reaching information rights or include the specific rules applying to listed companies in their company statutes or in the shareholder agreement.

swissVR Monitor: **How has the disclosure of Board remuneration evolved over time? Is there greater transparency today?**

Philippe Weber: The remuneration reports of listed companies are becoming more and more detailed. This is partly a result of the law but also reflects the fact that shareholder representatives – proxy advisers – and other stakeholders now scrutinise remuneration reports with a view to influencing remuneration. This may, for example, take the form of recommendations for voting at the Annual General Meeting or detailed feedback to companies. Meanwhile, corporate governance ratings by such institutions, including of remuneration, are now a popular tool.

Interestingly, companies are sometimes punished by shareholder representatives or the media for voluntarily being more transparent about remuneration issues than is required by law or for being more transparent than peer companies. Companies therefore need to find the right level of transparency and to ensure continuity and consistency in reporting, so that the information disclosed remains comparable from year to year.

swissVR Monitor: From your perspective as a lawyer, what are the legal challenges facing Board remuneration?

Philippe Weber: The remuneration rules for listed companies laid down in the Code of Obligations are very detailed and very rigid, and individuals breaching them may incur substantial penalties, including personal liability and long-term reputational damage, so it is essential that they comply strictly with the rules. If a Board is uncertain about how to apply the rules – for example whether a payment can be classed as 'remuneration' or is covered by the company statutes – then it would be well advised to seek guidance. Mistakes happen, but if a Board can demonstrate that it has exercised due care, complied with the legal formalities, declared any conflicts of interest and been advised by an expert, it is much less likely to run the risk of legal action. However, statutory risk is only part of the equation; reputational damage is now just as important to companies. My recommendation in relation to critical issues is therefore not only to commission a legal analysis but also to conduct what we might call a 'sniff test'. We now know of a number of cases where a Board has technically complied with the law but suffered long-term reputational damage as a result of not making the right judgement calls. In general terms, non-listed companies have greater flexibility, but it is important that there is no obvious imbalance between performance and reward and to note that, in some cases, unjustified payments may have to be repaid.

Another challenging issue is how social security rules handle remuneration for Board members. From a social security point of view, serving on a Board of Directors is normally considered as an employee-like gainful activity, so under Switzerland's pension rules, remuneration is subject to the provisions of both the AHV (the so-called «first pillar» of Swiss social security) and BVG (the so-called «second pillar» of Swiss social security) schemes. The specific application of these provisions in individual cases can, however, be a very complex question, for example where Board members have their principal residence outside Switzerland, have other employment, and/or have already retired. In these and other complex cases, it is best to obtain expert advice, not least as breaching the rules can, in the worst-case scenario, result in Board members facing individual liability.

Although directors and officers insurance (D&O) is not in legal terms an element of remuneration, Boards should ensure that the company has an appropriate D&O policy in place. 'Appropriate' means not just the level of cover but also cover for aspects excluded under other policies, such as lawsuits arising in the US.

To sum up, Board remuneration in listed companies is very closely regulated, and compliance is closely monitored not only by shareholders but also by their representatives (proxy advisers), the media and other stakeholders. Failure by a Board of Directors to comply with the principles of appropriateness and transparency may not just have legal consequences but also cause reputational damage both to the company and to individual Board members. The law applying to non-listed companies is different, and they do not have to follow the same rules on transparency; in such companies, shareholders have responsibility for establishing rules, either contractually or in the company statutes.